IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No. 61 of 1995

For Approval and Signature:

HONOURABLE MR.JUSTICE D.A.MEHTA
HONOURABLE MS.JUSTICE H.N.DEVANI

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1 Whether Reporters of Local Papers may be allowed to see the judgment ?

2 To be referred to the Reporter or not ?

3 Whether their Lordships wish to see the fair copy of the judgment ?

4 Whether this case involves a substantial question of law as to the interpretation of the constitution of India, 1950 or any order made thereunder ?

5 Whether it is to be circulated to the civil judge ?

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PATEL BRASS WORKS - Applicant(s)

Versus

COMMISSIONER OF INCOME TAX - Respondent(s)

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Appearance :
MR SN SOPARKAR for Applicant(s) : 1,
MR TANVISH U BHATT for Respondent(s) : 1,
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CORAM : HONOURABLE MR.JUSTICE D.A.MEHTA
and
HONOURABLE MS.JUSTICE H.N.DEVANI

Date : 16/01/2006

ORAL JUDGMENT

(Per : HONOURABLE MR.JUSTICE D.A.MEHTA)

1.The Income Tax Appellate Tribunal, Ahmedabad

Bench “A” has referred the following two questions under Section 256(1) of the Income Tax Act, 1961 (the Act) at the instance of the assessee:

> “[1] Whether, in the facts and circumstances of the case, the Income Tax Appellate Tribunal was right in law in holding that the appellant was not entitled to deduction of loss of Rs.80,000/- as business loss?
>
> [2] Whether, in the facts and circumstances of the case, the Income Tax Appellate Tribunal was right in law in holding that the appellant was not entitled to deduction of loss of Rs.80,000/- as short term loss?”

2. The assessment year is 1986-87, the relevant accounting period being Samvat Year 2041. The assessee, a registered firm, is engaged in the business of manufacturing spare-parts of diesel

engines. In the profit & loss account, a sum of Rs.80,000/- had been debited as capital loss on machinery. The facts in relation to the said entry are that the assessee entered into a contract for purchase of machinery worth Rs.10,09,000/- with M/s Godrej Boyce Mfg. Co. P. Ltd., Bombay vide letter dated 17/7/1984. The order was confirmed by the suppliers vide their letter dated 24/7/1984 calling upon the assessee to pay earnest money amounting to Rs.1,16,000/- for confirmation of the order. The assessee paid the amount as claimed. It is the case of the assessee that, as per terms of the contract, the machinery was to be supplied within a period of 12 months. Subsequently, the assessee gave up its plan to expand the business and cancelled the order for supply of machinery as per telex message dated 18/4/1985. The assessee simultaneously requested supplier to return earnest money of Rs.1,16,000/-. It appears that the assessee and the suppliers

entered into correspondence on this aspect and ultimately, the suppliers decided to return Rs.36,000/- after deducting Rs.80,000/- as cancellation charges. It is this amount of Rs.80,000/-, which is the bone of contention between the parties.

3.The assessee claimed the said amount as a business loss, and in the alternative, as a short term capital loss. The assessing officer negatived the claim of the assessee on both the counts. The assessee did not succeed in appeal either before Commissioner (Appeals) or the Tribunal.

4.Mrs.Swati Soparkar, the learned advocate appearing on behalf of the applicant assessee submitted that question No.1 is not pressed, on instructions, in light of the ratio of the Apex Court decision in case of Swadeshi Cotton Mills Co. Ltd. v. Commissioner of Income Tax, U.P.,

[1967] 63 ITR 65. In relation to question No.2, it was submitted that the Tribunal had committed an error in holding that there was no transfer of any capital asset giving rise to short term capital loss. According to the learned advocate, the assessee had acquired a valuable right in the form of the contract, namely, a right to acquire the machinery and on extinguishment of the said right, short term capital loss arose entitling the assessee to claim the same as such. Relying upon a decision of the Supreme Court in the case of Commissioner of Income Tax v. Mrs.Grace Collis, [2001] 248 ITR 323, it was submitted that it was not necessary that there should be a transfer of any asset for allowing such a loss; that it was sufficient if there was extinguishment of a right as distinct from and independent of transfer of the capital asset. It was submitted that the moment the contract was cancelled, the right possessed by the

assessee was extinguished resulting in short term capital loss.

5.Mr.T.U.Bhatt, the learned standing counsel for respondent revenue relied upon the impugned order of Tribunal as well as the decision of Bombay High Court in the case of Bharat Forge Co. Ltd. v. Commissioner of Income Tax, [1994] 205 ITR 339, to submit that the assessee was never in possession of any capital asset and hence, there was no question of the assessee being entitled to claim any capital loss.

6.The Scheme of the Act envisages a conjoint reading of provisions of Sections 45, 2(47) and 2(14) of the Act. Under section 45 of the Act, any profits or gains arising from the transfer of a capital asset effected in the previous year shall be deemed to be the income of the previous year in which the transfer took place. Therefore, for the charge of capital gains tax

or capital loss, the essential requirements are that there should be a transfer of a capital asset effected in the previous year. This would require ascertainment of the meaning of the terms “transfer” and “capital assets”. “Transfer” has been defined, in relation to a capital asset, to include various contingencies stipulated by sub-clauses of Section 2(47) of the Act. Sub-clause (ii) of Section 2(47) of the Act states that transfer includes the extinguishment of any right therein. That requires assigning meaning to the term “therein”. In other words, for the purposes of transfer of a capital asset, it would suffice if there is extinguishment of any rights in a capital asset. However, even for the purposes of extinguishment of any rights, existence of a capital asset is a must.

7. Section 2(14) of the Act defines “capital asset” to mean property of any kind held by an

assessee. For the present, it is not necessary to refer to the exclusionary clauses. The definition stipulates existence of property of every description and such property must be held by an assessee.

8. As can be seen from the facts of the case, the assessee had entered into a contract for purchase of machinery. The contract had been executed and entered into by the parties to the contract. The contract was in subsistence till the point of time the assessee cancelled the contract. Therefore, till that point of time, the assessee did not have any right which could be termed to be property so as to fall within the definition of “capital asset” as defined under section 2(14) of the Act. The right that the assessee had till that point of time was to make payment of the balance amount and take delivery of the machinery for which the order had been placed by the assessee. In other

words, the assessee was required to perform its part of the contract or show or express readiness and willingness to perform its obligation as emanating from the contract, namely, making payment of the balance amount towards machinery to be purchased, and then call upon the supplier to fulfill its part of the contract, namely, supply the machinery. Upon the supplier refusing to perform its part of the contract, the only right that could come into existence would be a right to sue for specific performance, and in the alternative, claim damages. However, in the present case, it was the assessee who was not willing to perform its part of the contract. Therefore, to claim that the assessee was in possession of a right which could be termed to be a capital asset within the meaning of section 2(14) of the Act, cannot be accepted and the Tribunal was justified in holding that the assessee was not in possession of any capital asset.

9.As already seen hereinbefore, the assessee was not holding any capital asset so as to enable the assessee to claim extinguishment of any rights in such a capital asset. Whether extinguishment per se is sufficient or whether it could operate as distinct and independent of transfer of a capital asset is not the issue in the present case, and hence, the decision in case of C.I.T. v. Mrs. Grace Collis (supra) relied upon by the learned advocate for the assessee, cannot carry the case of assessee any further. Even if the contention that extinguishment by itself is sufficient to constitute transfer is accepted, nonetheless, it is necessary for the assessee to establish that extinguishment is of any rights in a capital asset. The facts of the case reveal that the assessee never held any capital asset. The endeavour on behalf of the assessee to contend that the assessee was holding a right,

which itself was a capital asset, is not supported by the facts of the case. The only right that the assessee had, till the point of time it cancelled the contract, was to perform its part of the contract and seek performance of the contract from its suppliers. This could not be termed to be a capital asset, howsoever wide the definition of “property” may be cast.

10.In these circumstances, when the Tribunal came to the conclusion that the concluded contract between the assessee and the suppliers through the exchange of letters was not a capital asset in the hands of the assessee, and there was no transfer whatsoever within the meaning of Section 2(14) of the Act, it cannot be said to be incorrect. Even if the unilateral act of cancellation of contract would amount to extinguishment, it would be extinguishment only of the right to seek performance of the contract after showing the willingness to

perform its part of the contract.

11.Therefore, in absence of any infirmity in the impugned order of Tribunal, question No.2 is answered in the affirmative. The Tribunal was right in law in holding that the assessee was not entitled to deduction of Rs.80,000/- as short term capital loss. The question is accordingly answered in favour of the revenue and against the assessee.

12.The Reference stands disposed of accordingly. There shall be no order as to costs.

[D.A.MEHTA, J.]

[HARSHA DEVANI, J.]

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